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UNCLAS SECTION 01 OF 02 HANOI 001918

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USDOC FOR 4431/MAC/IFP/OKSA/HPPHO
BANGKOK FOR USAID

E.O. 12958: N/A
TAGS: EFIN ECON VM FINREF
SUBJECT: VIETNAM RESPONDS TO INFLATIONARY PRESSURE

¶1. SUMMARY. Vietnam's CPI has registered an increase of 7.2% so far this year. While the GVN attributes this rise to external forces such as oil prices, the CPI is also heavily weighted to reflect rises in the price of food and foodstuffs. Credit growth has also rapidly increased by 33% this year. The inflationary pressures resulting from these developments have prompted the State Bank of Vietnam to follow the IMF's advice and raise the compulsory reserve ratio for both Vietnam Dong and U.S. Dollar deposits. END SUMMARY.

SERIOUS INFLATION OR FAULTY CPI?

¶2. (U) In recent months, inflation has been on the rise in Vietnam. The Government Statistics Office (GSO) estimates Vietnam's Consumer Price Index (CPI) to have increased 7.2% from December 2003 - June 2004. The monthly CPI for June continued to rise 0.8% compared to May. The year-to-date increase surpassed the GVN target by nearly 1.5 times. According to the IMF, Vietnam's year-on-year inflation (June 03 - June 04) is 8.3%.

¶3. (U) Explanations for the rate increase vary. The GSO cites the increase in oil prices as the main factor, but the IMF sees a domestic explanation. The IMF rep contends that droughts caused food prices to rise and the large weight of this component in the CPI (nearly half) was the primary factor in the increase. The IMF contends that if Vietnam only calculated "core" inflation (i.e. without foodstuffs and fuel prices) the situation would appear more benign. Vietnam's CPI basket includes 400 goods and services in 10 basic categories. Food and foodstuffs account for nearly half of the total. Of the other 9 categories, the other primary areas are: transportation and communication (including energy) at 10%, housing and building materials at 8%, and household appliances at 9%. The food and foodstuffs component has risen dramatically in the past year by 13-14% while the other components have only risen by an average of about 2%. The price of pharmaceuticals has also been on the rise lately, but the category only accounts for 2.41%. The local World Bank office points to increases in the prices of steel and fertilizer, as well as temporary price shocks from the outbreak of Avian Influenza earlier this year and the subsequent ban on the sale of poultry meat and eggs.

EXPECTATIONS

¶4. (U) GVN officials from various ministries have made predictions about the eventual year-end inflation rate to include worst-case scenarios should government actions not succeed in reducing inflation. According to press reports, Vice Minister of Finance Nguyen Ngoc Tuan anticipates that the monthly CPI for July will increase by 0.8% or more and that the annual CPI for this year may reach 9%. The press also reported that the Ministry of Trade, following a recent inter-agency meeting, predicted a 10-12% CPI at year's end as the worst-case scenario.

¶5. (U) Many newspapers have also carried commentary by non-governmental observers, some of it echoing the government's worst-case scenarios. In an article in the newspaper Tuoi Tre dated June 24, Vietnamese-American Pham Do Chi, a regional economic expert who is frequently interviewed by the paper, believes that if the GVN can manage a "soft Landing" and cool down economic growth to about 6.5 - 7% then the annual inflation rate might be curbed at 7 - 8%. However, should the GVN fail to cool down the economy, he predicts inflation could reach 10% by the end of the year.

EFFECT ON CONSUMERS

¶6. (U) While the local IMF rep believes that the inflationary pressures primarily resulted from an imbalance in the CPI and would have likely proved to be transitory, she and new IMF Managing Director Rodrigo de Rato (who was in Hanoi June 26) urged the GVN to act to stem the development of an inflationary psychology among consumers.

They feared that transitory price increases might eventually combine with an increase in civil service wages scheduled for this October to create real inflationary pressures. The resulting consumer behavior would then begin to fuel the inflation rate.

¶7. (U) Recent Vietnamese press reports on inflation have been fairly accurate, but they may still have a negative impact on consumer behavior. Several recent articles pointed to a trend among Vietnamese of moving their savings from VND deposits to USD deposits. In an effort to calm the fears of the public, SBV Governor Le Duc Thuy and several senior officials at large, state-owned commercial banks have made themselves available for interviews with various newspapers. However, the mere appearance of headlines on inflation has probably already increased consumer anxiety.

SBV ACTS TO STEM CREDIT GROWTH

¶8. (U) To relieve inflationary pressure, the State Bank of Vietnam (SBV) raised the compulsory reserve rate for Vietnam Dong (VND) and U.S. Dollar (USD) deposits. SBV raised the reserve requirement for VND short-term and at-call deposits from 2% to 5% and doubled the rate for VND medium and long-term deposits to 2%. The rate for USD short-term and at-call deposits was doubled to 8%, and the rate for USD medium and long-term deposits was also doubled to 2%. The Bank of Agriculture and Rural Development raised rates for VND short-term deposits from 1.5% to 4%, but the rate for VND medium and long-term deposits remained unchanged at 1.5%. The SBV hopes these actions will stem the rapid growth of credit. So far this year, according to the IMF, credit has expanded at a rate of 33%, compared with 28.4% in 2003. State-owned enterprises or state-directed development projects receive the majority of these loans that generally prove to be underperforming loans. According to reports in the July 1, 2004 newspaper Lao Dong, many large commercial banks say that they do not plan to raise interest rates in the coming weeks.

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